COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF THE NEED FOR AFFILIATE TRANSACTION RULES AND COST ALLOCATION REQUIREMENTS FOR ALL JURISDICTIONAL UTILITIES	)	ADMINISTRATIVE CASE NO. 369

O R D E R

On December 19, 1997, the Commission initiated this proceeding to investigate: 1) the cost allocation and affiliate transaction rules for electric, gas, water, and sewer utilities; and 2) the code of conduct rules for all regulated utilities that engage in non-regulated activities. The Commission issued information requests relating to these two subjects, and responses were received from 28 interested parties. Based on a review of those responses, the Commission finds that many utilities are adhering to some form of these rules, either on a voluntary basis or pursuant to a regulatory requirement. However, the absence of uniform rules applicable to all utilities contributes to regulatory inefficiencies and increases the risk of ratepayers subsidizing non-utility activities. Thus, the Commission believes that the adoption of formalized cost allocation guidelines and a code of conduct for affiliate transactions is desirable.

The Commission has developed draft versions of both documents, based on the guidelines already in place for some utilities in Kentucky and in other jurisdictions. Appendix A to this Order contains the draft cost allocation guidelines which, if adopted, will apply to each jurisdictional electric, gas, water, and sewer utility which engages in non-regulated activities, whether those activities are conducted through the utility or a separate affiliate. These guidelines are not intended for the telecommunication utilities, since they already operate under mandatory cost allocation rules. Appendix B to this Order contains the draft code of conduct which, if adopted, will apply to all regulated utilities in Kentucky.

The draft cost allocation guidelines and draft code of conduct are being sent to all interested parties for their review and comment. All comments, including any proposed alternative rules applicable to small utilities or cooperatives, should be in writing and filed within 60 days. The Commission encourages those parties with similar interests to file their comments jointly. All parties will then have an opportunity to participate in an informal conference to discuss the attached drafts and the filed comments.

IT IS THEREFORE ORDERED that:

1. All parties shall have 60 days from the date of this Order to file an original and 12 copies of comments on the draft cost allocation guidelines and draft code of conduct, set forth in Appendices A and B, respectfully, with copies to all parties on the service list.

2. An informal conference shall be held on November 18, 1998, at 9:00 a.m. Eastern Standard Time, in Hearing Room 1 at the Commission's offices at 730 Schenkel Lane, Frankfort, Kentucky.

3. The revised service list for this proceeding is set forth in Appendix C, attached hereto.

Done at Frankfort, Kentucky, this 3rd day of September, 1998.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN ADMINISTRATIVE CASE NO. 369 DATED September 3, 1998

COST ALLOCATION AND AFFILIATE TRANSACTION GUIDELINES

These guidelines shall apply to any utility that engages in any nonregulated activity or conducts any business with a nonregulated division, subsidiary, or affiliate. The purpose is to ensure that all appropriate costs, including common costs, of providing nonregulated services or products are allocated to the nonregulated activity and are not subsidized by the utility's ratepayers.

For the purposes of these guidelines, an affiliate is considered to be any party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the utility. Control is considered to be the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise.

1. Cost Allocation Methods. Regulated utilities that engage in any nonregulated activity must identify all costs of the nonregulated activity and report those costs in accordance with the applicable uniform system of accounts ("USoA"). The fully distributed cost method should be utilized in allocating costs between regulated and nonregulated activities. This method requires the examination of all costs of an entity in relation to all the goods and services that are produced. All costs incurred directly or indirectly to produce a good or service must be recognized as a cost of that good or service. Costs are assigned either directly or using a logical basis for allocation. Costs

that cannot be directly assigned or indirectly allocated must be included in the fully distributed cost calculation through a general or common allocation.

a. Direct Assignment. If only one service or product causes a cost to be incurred or benefits from a cost, that cost should be directly assigned to either regulated or nonregulated operations. Costs should be directly assigned to the greatest extent possible.

b. Indirect Assignment. If a cost is caused by or benefits both regulated and nonregulated activities and cannot be directly assigned, it should be allocated using a direct and logical measurement of cost causation if such a measurement exists.

c. Common Allocation. If a cost is common to both regulated and nonregulated activities and a direct measurement of cost causation is not apparent, an allocation formula should be used to distribute the cost in a reasonable manner that is equitable for both regulated and nonregulated operations. Revenues should not be used as a factor in the formula unless the utility can prove a direct cost causation with the revenues. Generally, revenue based allocations are not based on cost causation or utilization of resources.

d. Incidental Treatment. An incidental nonregulated service may be treated as regulated for purposes of cost allocation if the total revenue of all incidental activities do not exceed one percent (1.0%) of total utility company revenue and the service is an outgrowth of the utility's regulated operations performed by utility personnel with utility facilities.

2. Filing Requirements for Cost Allocation Manual. Each utility which engages in any nonregulated activity, other than activities which are incidental as defined above,

shall file a written cost allocation manual ("CAM") with the Public Service Commission. If the Commission does not object or request additional information within 60 days of the date filed with the Commission, the CAM is considered accepted. Approval of allocation procedures for ratemaking purposes shall only be done within the context of a rate case; therefore, acceptance of the CAM as filed does not constitute acceptance of the allocation methodology for ratemaking purposes.

a. Initial Filing. The initial filing under these guidelines shall be made within 180 days of the effective date of the guidelines or such other time to accommodate a staggered filing schedule if one is established by the Commission.

b. Updates. Updates or changes to the CAM shall be filed with the Commission when made. If the Commission does not object or request additional information within 30 days of the date filed with the Commission, the update or change is considered accepted.

c. Filings by Industry Group. Industry groups or associations are encouraged to work together to develop a standardized CAM to be used by small companies in their industries.

3. Contents of Cost Allocation Manual. Each utility's CAM shall include the following information:

a. Utility Divisions. A list of all regulated and nonregulated divisions within the utility.

b. Affiliated Entities. A list of all regulated and nonregulated subsidiaries and affiliates.

c. Services and Goods Provided. A list of the services and goods provided by the utility and identification of each as regulated or nonregulated.

d. Incidental Nonregulated Services and Goods. A list of nonregulated services and goods that are expected to qualify for incidental treatment in accordance with section 1. d. of these guidelines.

e. Allocation Methodology. For each USoA account and sub-account, a specification of the services or products identified above which have costs allocated to that account or sub-account and a description of the methodology used to perform the allocation. The allocation methodology shall be consistent with the principles identified in section one of these guidelines.

f. Affiliated Transactions. Descriptions of the nature of all anticipated transactions between the utility and a nonregulated division, subsidiary, or affiliate.

g. Deviations from Transaction Pricing Guidelines. Descriptions of the expected terms of all anticipated transactions between the utility and a nonregulated division, subsidiary, or affiliate to the extent those terms are inconsistent with the guidelines stated herein.

h. Proprietary Treatment. A utility may request that certain portions of its CAM be treated as proprietary. Each request will be evaluated by the Commission pursuant to 807 KAR 5:001, Section 7.

4. Affiliate Transaction Pricing. The terms for transactions between the regulated utility and a nonregulated division, subsidiary, or affiliate shall be in accordance with the following guidelines:

a. Goods and Services Transferred from Utility to Affiliate. Goods and services provided to a nonregulated division, subsidiary, or affiliate by the regulated utility pursuant to a tariff shall be at the tariffed rate. Nontariffed items shall be priced at the utility's fully distributed cost.

b. Goods and Services Transferred from Affiliate to Utility. Goods and services provided to the regulated utility by a nonregulated division, subsidiary, or affiliate shall be priced at the affiliate's cost.

c. Assets Transferred from Utility to Affiliate. The transfer or sale of assets by the utility to a nonregulated division, subsidiary, or affiliate shall be priced at the greater of the utility's fully distributed cost or fair market value.

d. Assets Transferred from Affiliate to Utility. The transfer or sale of assets by a nonregulated division, subsidiary, or affiliate to the regulated utility shall be priced at the lower of the affiliate's cost or fair market value.

e. Deviations from Affiliated Transaction Pricing Guidelines. The regulated utility may file an application with the Commission requesting a deviation from the affiliated transaction guidelines for a particular transaction or class of transactions. The utility shall have the burden of demonstrating that the requested pricing is more appropriate and the result is just and reasonable. The Commission may grant the deviation if it is determined to be in the public interest.

5. Demonstration of Compliance with Guidelines. In an application for base rates, the regulated utility must demonstrate compliance with the Commission's cost allocation and affiliate transaction guidelines.

a. Utility to Document Compliance. In any formal Commission proceeding at which cost allocation is at issue, the utility shall provide sufficient information to document that its cost allocation procedures and affiliate transaction pricing are consistent with these guidelines and with the utility's filed CAM. If the Commission deems the evidence provided by the utility to be insufficient or finds there is good cause or evidence to indicate the utility has not complied with these guidelines or its filed CAM, the utility may be required to perform a cost study.

b. Utility to Provide Information. The utility shall provide sufficient information for another party to perform a cost study in response to relevant data requests through the Commission's discovery process.

6. Access to Records. The Commission shall have access to the books and records of a utility's subsidiary or affiliate company to ensure that transactions between the two entities comply with the requirements established herein. If necessary access to records to determine compliance is not provided, the costs attached to the affiliate transactions may be disallowed from rates. The Commission shall have the right to audit or order an audit to be performed to determine the utility's compliance with the Commission's cost allocation and affiliate transaction guidelines.

7. Additional Filing Requirements. The Commission may require that the utility and its affiliates file periodic reports of information related to affiliate transactions when necessary to monitor compliance with these guidelines.

8. Prudence Review. Conformance with these guidelines shall not preclude the Commission from evaluating the prudence of any transaction, investment, or expense.

9. Waivers and Deviations. A utility may file an application for a waiver or deviation from any or all provisions of these guidelines. Any such application shall demonstrate the basis of the utility's contention that it should be granted a waiver or deviation, including, if appropriate, documentation regarding the costs and benefits of compliance. For good cause shown, the Commission may grant a waiver or deviation if compliance is determined to be impracticable or unreasonable under the circumstances.

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN ADMINISTRATIVE CASE NO. 369 DATED September 3, 1998

CODE OF CONDUCT FOR UTILITIES

WITH NONREGULATED ACTIVITIES OR AFFILIATES

A code of conduct governs a public utility company's activities relative to the sharing of information, databases and resources between its employees or affiliates involved in the marketing or provision of nonregulated services and its employees or affiliates involved in the provision of regulated services. An affiliate is defined as a person that directly, or indirectly through one or more intermediaries, controls, is controlled by or is under common control with the utility. Control is considered to be the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise. These guidelines shall apply to any utility that engages in any nonregulated activity or conducts any business with a nonregulated division, subsidiary, or affiliate.

1. A utility and its affiliates must be separate corporate entities and maintain separate books and records. Any utility that engages in nonregulated activities directly rather than through an affiliate shall separately account for all investments, revenues, and expenses in accordance with its filed cost allocation manual.

2. A utility may not provide advertising space in its billing envelope to its affiliates or for its nonregulated activities unless it offers the same to competing service

providers on the same terms it provides to its affiliate. This rule applies to competitive services only.

3. A utility may not attempt to persuade customers to do business with its affiliates by offering rebates or discounts.

4. A utility may not solicit business on behalf of its affiliate or for its nonregulated activities or speak or give the appearance of speaking on behalf of its affiliate.

5. A utility may carry out any promotion, advertising sales, marketing or research and development with its affiliate or for its nonregulated activities subject to cost allocation guidelines.

6. All electric company employees engaged in the merchant function shall abide by all standards promulgated by applicable Federal Energy Regulatory Commission orders and regulations.

7. No utility employee shall share any customer information with its affiliate unless such information is readily publicly available or is simultaneously made publicly available.

8. All dealings between a utility and its affiliate shall be at "arms length." "Arms length" is defined as the standard of conduct under which unrelated parties, each party acting in its own best interest, would negotiate and carry out a particular transaction.

9. A utility may not share marketing and business plans or market research with an affiliate.

10. Employees transferring from the utility to an affiliate may not take with them

competitively sensitive information or material of any kind.

11. Where a utility offers a nonregulated service, marketing employees shall not have access to customer information provided to order takers.

12. Utilities may not provide any type of preferential treatment to its affiliates to the detriment of a competitor.

13. If a utility receives a request for a recommendation from a customer seeking a specific service which is offered by the utility's affiliate, or by the utility itself, the utility must provide the customer with the names of several competing suppliers of that service, if it mentions its own affiliate or that it provides the service.

14. The utility name or logo shall not be used by an affiliate unless a disclaimer is used. The form, content and appearance of the disclaimer shall be pre-approved by the Commission.

15. A utility shall not provide credit support for its affiliates.

16. Utilities shall inform the Commission of all new nonregulated activities on a time-concurrent basis.

17. Start-up costs associated with the formation of an affiliate shall be borne by stockholders.

18. The Commission may require that the utility and its affiliates file periodic reports of information related to affiliate transactions when necessary to monitor compliance with these guidelines.

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN ADMINISTRATIVE CASE NO. 369 DATED September 3, 1998

See Attached Service List

Errol K. Wagner
Director of Regulatory Affairs
American Electric Power
1701 Central Avenue
P. O. Box 1428
Ashland, KY. 41101 1428

Gene Baldrate
Vice President-Regulatory Affairs
Cincinnati Bell Telephone Company
201 East Fourth Street
P. O. Box 2301
Cincinnati, OH. 45201

Daniel McKenzie
General Manager
Mountain Rural Telephone
Cooperative Corporation
405 Main Street
P. O. Box 399
West Liberty, KY. 41472 0399

Ronald L. Willhite
V.P., Regulation & Economic Planning
Kentucky Utilities Company
One Quality Street
Lexington, KY. 40507

William W. Magruder
Executive Vice President
Duo County Telephone Cooperative
Corporation, Inc.
1021 West Cumberland Avenue
P. O. Box 80
Jamestown, KY. 42629

F. Thomas Rowland
Executive V.P./General Manager
North Central Telephone
Cooperative, Inc.
Highway 52 By-Pass
P. O. Box 70
Lafayette, TN. 37083

Honorable Theodore J. Schneider
David T. Musselman, Attorneys
The Union Light, Heat & Power
Company
139 E. Fourth Street
Cincinnati, OH. 45201

Paul E. Preston
General Manager
Foothills Rural Telephone
Cooperative Corporation, Inc.
1621 Kentucky Route 40 W
P. o. Box 240
Staffordsville , KY. 41256

Keith Gabbard
Manager
Peoples Rural Telephone
Cooperative Corporation, Inc.
P. O. Box 159
McKee, KY. 40447

John F. Hall
Vice President-Finance, Sec.,Treas.
Delta Natural Gas Company, Inc.
3617 Lexington Road
Winchester, KY. 40391

Larry D. Callison
State Manager-Regulatory Affairs
GTE South, Inc.
KY10H072
150 Rojay Drive
Lexington, KY. 40503

Robert C. Thacker
President, General Manager
Thacker-Grigsby Telephone
Company, Inc.
9500 Communications Lane
P. O. Box 789
Hindman, KY. 41822

R. Earl Fischer
President
Western Kentucky Gas Company
2401 New Hartford Road
P. O. Box 866
Owensboro, KY. 42302

Paul R. Grearheart
President
Harold Telephone Company, Inc.
P. O. Box 160
Harold, KY. 41635

Glen B. Sears
General Manager
West Kentucky Rural Telephone
Cooperative Corporation, Inc.
237 North Eighth Street
P. O. Box 649
Mayfield, KY. 42066 0649

Rick Taylor
Area Manager - Operations
ALLTEL Kentucky, Inc.
229 Lees Valley Road
Shepherdsville , KY. 40165

F. L. Terry
General Manager
Highland Telephone Cooperative,
Inc.
7840 Morgan County Hwy.
P.O. Box 119
Sunbright, TN. 37872

Michael H. Core
President/CEO
Big Rivers Electric Corporation
201 Third Street
P. O. Box 24
Henderson, KY. 42420

Creighton E. Mershon, Sr.
Regulatory Vice President
BellSouth Telecommunications, Inc.
601 West Chestnut Street, Room 408
P. O. Box 32410
Louisville, KY. 40232

Clint Quenzer
Interim General Manager
Logan Telephone Cooperative, Inc.
P. O. Box 97
Auburn, KY. 42206

Charles A. Lile
Senior Corporate Counsel
East Kentucky Power Cooperative,
Inc.
4775 Lexington Road
P. O. Box 707
Winchester, KY. 40392 0707

Herbert A. Miller, Esq.
Vice President & Manager
Kentucky American Water Company
2300 Richmond Road
Lexington, KY. 40502

Mr. Mike Bethurem
Utilities Administrator
Berea College
Utility Office CPO 2337
Berea, KY. 40404

Stephen B. Seiple
Senior Attorney
Columbia Gas of Kentucky
P.O. Box 117
200 Civic Center Dr.
Columbus, OH. 43216 0117

Daryl Wyan
Interim General Manager
South Central Rural Telephone
Cooperative Corporation, Inc.
P.O. Box 159
Glasgow, KY. 42141 0159

Hon. Lizbeth A. Tully
Counsel for Berea Utilities
Stoll, Keenon & Park LLP
201 East Main Street
Suite 1000
Lexington, KY. 40507

Richard S. Taylor
Hazelriggs & Cox
Columbia Gas of Kentucky
415 West Main Street
Frankfort, KY. 40602

Mr David F. Boehm
Kentucky Industrial Utilities
Customers, Inc.
2110 CBLD Center
36 E. Seventh Street
Cincinnati, OH. 45202

Mr. Darrell Mennenga
Alltel Communications, Inc.
One Allied Drive
P.O. Box 2177-72203
Little Rock, AR. 42202 2013

Lee Allen Everett
Vice President of Price Policy and
Administration
Atmos Energy Corporation
P.O. Box 650205
Dallas, TX. 75265

Honorable John D. Myles
Attorney for KAPHCC
and Modern Security
413 Sixth Street
Shelbyville, KY. 40065

Hon. James M. Miller
Esq.
Sullivan, Mountjoy, Stainback
& Miller, P.S.C.
100 St. Ann Building
PO Box 727
Owensboro, KY. 42302 0727

Honorable John N. Hughes
Attorney for
Western Kentucky Gas Company
124 W. Todd Street
Frankfort, KY. 40601

Ms. Elizabeth E. Blackford
Assistant Attorney General
Attorney General Office
1024 Capital Center Drive
Frankfort, KY. 40601

Hon. Herbert D. Liebman
Attorneys at Law
Liebman & Liebman
PO Box 478
Frankfort, KY. 40602

Robert M. Watt III
201 East Main Street
Suite 1000
Lexington, KY. 40507

Mr. Douglas M. Brooks
Sr. Counsel Specialist, Regulatory
Louisville Gas & Electric Company
220 W. Main St.
PO Box 32010
Louisville, KY. 40232

Nancy Rue
Frost & Jacobs LLP
2500 PNC Center
201 East Fifth Street
Cincinnati, OH. 45202 4182

J.D. Tobin, Jr.
President
Brandenburg Telephone Cpmpany
332 East Broadway
Brandenburg, KY. 40108

Hon. Lindsey W. Ingram, Jr.
Attorney for Independent Telephone
Stoll, Keenon & Park, LLP
201 East Main Street, Suite 1000
Lexington, KY. 40507 1380

Bruce F. Clark
Stites & Harbison
421 West Main Street
P.O. Box 634
Frankfort, KY. 40602 0634

Harlon E. Parker
General Manager
Ballard Rural Telephone
P.O. Box 209
La Center, KY. 42056

CASE NUMBER:000369

Douglas C. Walther
Atmos Energy Corporation
P.O. Box 650205
Dallas, TX. 75265 0205

Kendrick R. Riggs
J. Wade Hendricks
Osden, Newell & Welch
1700 Citizens Plaza
500 W. Jefferson St.
Louisville, KY. 40202 2874

Richard S. Minch
Manager, Regulatory Services
Columbia Gas of Kentucky, Inc.
2001 Mercer Road
P.O. Box 14241
Lexington, KY. 40512 4241

Frank K. Downing
President/CEO
Owen Electric Cooperative, Inc.
510 S. Main St.
P.O. Box 400
Owenton, KY 40359

CASE NUMBER:000369